


MEMORANDUM

TO: Management and Fiscal Policy Committee

FROM: Robert H. Drummer, Senior Legislative Attorney
Charles H. Sherer, Legislative Analyst 

SUBJECT: Resolution to Approve Reserve and Selected Fiscal Policies
Bill 36-10, Finance – Revenue Stabilization Fund – Amendments

A Resolution to Approve Reserve and Selected Fiscal Policies and Bill 36-10, Finance – Revenue Stabilization Fund – Amendments, both sponsored by the Council President at the request of the County Executive, were introduced on May 27, 2010. A Management and Fiscal Policy Committee (MFP) worksession for both the Resolution and Bill was held on June 14. A public hearing was held on June 22.

Summary

The Resolution would establish a goal of a structurally balanced budget where only recurring revenue is used to fund recurring expenses. The Resolution would also gradually increase the target total reserve over the next 9 years and thereby reduce the revenue available for agency spending. Bill 36-10 would amend the law governing the Revenue Stabilization Fund consistent with the proposed new fiscal policies governing the reserve. The Bill would modify the method of determining the mandatory annual contribution to the Fund and remove the current cap on the Fund.

The major policy issues are:

1. Should the Council adopt a policy goal of a structurally balanced budget?
2. Should the Council modify the method of calculating the total reserve?
3. Should the Council modify the amount of the target reserve?
4. Should the total reserve have a maximum size? If so, what should it be?
5. Should the Revenue Stabilization Fund continue to have a maximum size? If so, what should it be?

Background

During FY10, three events occurred that caused the Executive to propose increasing the County's reserve: 1) the April 22 estimate of General Fund revenues in FY10 was \$238 million less than the estimate the Council made in May 2009 when the Council approved the FY10 budget; 2) three huge snow storms cost \$57 million more than was in the budget; and 3) Moody's Investors Service indicated that the County's AAA bond rating might be downgraded, based largely on their concern that the County's reserve is too low. The County's financial advisor, Public Financial Management, Inc. (PFM), prepared an overview of the County's financial risks and recommended several policy changes. See the PFM presentation at ©25-35. In a memorandum dated May 21, 2010 regarding Reserve and Selected Fiscal Policies, the Executive recommended that the Council approve:

- a) a resolution to establish policies regarding reserves, including the Revenue Stabilization Fund (RSF), and other fiscal matters; and
- b) a Bill to change the RSF law.

The main purpose of the Resolution and Bill is to increase the reserve, which could require the Council to decrease expenditures and/or to increase revenues. Since revenues are at or close to their maximum, unless the Council exceeds the Charter limit on property taxes, expenditures are more likely to be reduced than revenues are to be increased. The Resolution and Bill would make a number of changes to existing policy and law to achieve the increase in reserve.

The calculation of the target reserve for FY11 using the "old"/current policy compared to using the proposed new policy is on ©21. The new reserve policy would both increase the percent of total resources for the target reserve and modify the base used to calculate the target reserve.

The target reserve under the old policy is 6% of total resources minus the RSF. The base is:

- 1. Revenue in the 4 tax supported agencies;
- 2. Plus net transfers in from non tax supported funds (such as from the Department of Liquor Control and the Cable Fund);
- 3. Plus total reserve at the beginning of the year; and
- 4. Minus the RSF at the beginning of the year.

The target reserve under the proposed new policy would be 10% of Adjusted Governmental Revenue (AGR), defined as:

- (1) Tax-supported County governmental funds revenues, plus revenues of the:
- (2) County Grants Fund;
- (3) County Capital Projects Fund;
- (4) tax supported funds of the Montgomery County Public Schools, not including the County's local contribution;

- (5) tax supported funds of Montgomery College, not including the County's local contribution; and
- (6) tax supported funds of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission.

Components 1 and 4 through 6 are the same as is currently used to calculate the amount of target reserve at 6%. Components 1 and 4 through 6 are listed separately in the definition of AGR to coincide with the accounting definitions used in the County's financial statements, but they represent the tax supported revenues in the 4 tax supported agencies. The second and third components are not currently used, but Finance Department staff recommend including them in the proposed new 10% goal because the County has to advance County cash and wait for collection or reimbursement for most of the revenue. The amount of the existing reserve at the beginning of the year is currently used to calculate the 6% target reserve, but would not be used to calculate the 10% target reserve under the proposed policy. A simpler way of describing AGR under the proposed new policy would be:

1. Revenue in the 4 tax supported agencies;
2. Plus the County Grants Fund; and
3. Plus the County Capital Projects Fund.

The Grants Fund includes activity relating to operating grants funded primarily by Federal and State grants. The Capital Projects Fund includes activity relating to the capital improvements program (CIP) projects.

Although the 6% and the 10% targets are multiplied by different bases, the 2 different bases are similar in size. Therefore, the proposed 10% policy would always result in a higher reserve. For FY11, the 10% goal would have resulted in a reserve at the end of FY11 that is \$163.1 million higher than the 6% goal, so the Council would have had to reduce spending or increase revenue by that amount.

To mitigate the impact of increasing the amount of the reserve from 6% of tax supported resources to 10% of AGR, the Executive proposed phasing in the increase over the 9 year period FY12-20. As shown on ©22, Finance and OMB project that phasing in the 10% goal would result in lower spending and a higher reserve each year. **This would be the impact of the proposed new goal.**

Council staff recommends approval of the Resolution and Bill with changes noted below.

June 14 MFP Worksession

The Committee discussed the proposed Resolution and Bill with Executive staff and the County's financial advisor, Nancy Winkler of PFM. The Committee did not vote on the Bill or the Resolution. Committee Chair Trachtenberg and Committee member Ervin preliminarily agreed with the Executive's proposal to remove the cap on total reserve, subject to further discussion. Committee member Navarro asked staff to develop options for a cap. The Committee is scheduled to meet again on June 24 to make recommendations to the Council.

Public Hearing

Jennifer Barrett testified in support of the Resolution and the Bill on behalf of the Executive at the public hearing on June 22. See ©38.

Issues Relating to the Resolution

1. Should the Council establish a policy goal of a structurally balanced budget?

Action Clause 1 in the Resolution states:

“1. Structurally Balanced Budget

Montgomery County will have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.”

If non-recurring revenues are used to fund recurring expenses in one year, and if the non-recurring revenue does not recur the following year, then there will be a shortfall in revenues because the expense will recur. Note that neither transfers in nor reserve at the beginning of the year can be used to fund the budget under the proposed policy. The amount of reserve at the beginning of the year can and does vary from year to year, so not using it to fund recurring expenses makes sense. However, at least some (if not most) of the transfers in, such as the transfer from the Department of Liquor Control (DLC), is recurring, and Council staff recommends that the recurring portion of transfers in be used to fund recurring expenses. In other words, the ceiling on the operating budget would be recurring revenues plus recurring transfers in.

Note that the reserve should not be used to fund the budget under the proposed new policy, so budgeted reserve would never decrease and would continue to increase each year due to the proposed mandatory contribution to the Revenue Stabilization Fund (RSF) in Bill 36-10, until the total reserve (RSF plus General Fund) reached the ceiling, if any. (Actual reserve would of course decrease if revenue were less than budgeted and/or spending was more than budgeted.)

Budgeted expenditures under the proposed policy cannot exceed recurring revenues (plus recurring transfers in) less the mandatory contribution to the required reserve.

Council staff recommendation: modify Action Clause 1 as follows:

1. Structurally Balanced Budget

Montgomery County ~~[[will]]~~ must have a goal of a structurally balanced budget, ~~[[, that is, budgeted]]~~ Budgeted expenditures should not exceed projected recurring revenues plus recurring net transfers in minus the mandatory contribution to the required reserve for that

fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.

2. Should the total reserve have a maximum size?

Action Clause 2 in the Resolution states:

“2. Reserves

Montgomery County will have a goal of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund Balance to an amount equal to approximately 10% of Adjusted Governmental Fund revenues, representing tax-supported governmental and agency revenues, including operating grant and CIP revenues. This goal will be reflected in the Revenue Stabilization Fund law.”

Bill 36-10 would remove the ceiling on the size of the RSF, and the mandatory contribution in County Code §20-68(a) would permit the size of the RSF to increase without limit, as explained below in the discussion of the Bill.

Council staff believes that the Council should specify a maximum size of the total reserve (GF plus RSF) and recommends that this maximum size be 25% of AGR. Council staff believes that there should be a limit on how much taxpayer money is set aside for contingencies. Finance staff believes that the proposal to eliminate the existing cap described below in the discussion of the Bill is prudent since the 10% target can only be exceeded by a mandatory contribution based upon 50% of excess revenue. Finance staff also noted that the 10% target reserve is only 36 days, which is much less than the 60 days or 2 months of operating expenses recommended as a target reserve by the Government Finance Officers Association (GFOA). The GFOA recommendation for the appropriate level of unrestricted fund balance is at least 2 months of expenses. See ©23-24.

A 2 month reserve would be 17% of AGR. A 3 month reserve would be 25% of AGR. Based upon the GFOA recommended minimum of 17% of AGR, a maximum total reserve of 25% AGR would balance the County’s need for a sufficient reserve while still limiting how much taxpayer money is set aside for contingencies.

With regard to the General Fund (GF) reserve, §310 of the Charter limits the reserve in the GF to 5% of the GF revenue in the **preceding** fiscal year. The Executive’s May 21, 2010 memorandum recommended setting aside this 5% maximum every year. Council staff agrees and would include this in Action Clause 2.

Council staff recommendation: amend Action Clause 2 as follows:

2. Reserves

Montgomery County ~~[[will]]~~ must have a goal of achieving the Charter §310 maximum for the reserve in the General Fund of 5% of General Fund revenues in the preceding fiscal year, and of building up and maintaining the sum of Unrestricted General Fund Balance and

Revenue Stabilization Fund ~~[[Balance to an amount equal to approximately]]~~ reserve to 10% of Adjusted Governmental Fund revenues, ~~[[representing tax-supported governmental and agency revenues, including operating grant and CIP revenues]]~~ as defined in the Revenue Stabilization Fund law. This goal ~~[[will]]~~ must be reflected in the Revenue Stabilization Fund law. The budgeted total reserve must not exceed 25% of Adjusted Governmental Fund revenues.

3. Should the Council establish a priority for the use of one-time revenues?

Action Clause 3 states:

“3. Use of One-Time Revenues

One-time revenues and revenues in excess of projections will be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or Retiree Health Benefits Prefunding (OPEB).”

Council staff recommends that the Council add a sentence to this policy statement requiring priority consideration to unfunded liabilities, Retiree Health Benefits Prefunding (OPEB) and Pension Benefits Prefunding.

Council staff recommendation: amend Action Clause 3 as follows:

3. Use of One-Time Revenues

One-time revenues and revenues in excess of projections ~~[[will]]~~ must be applied first to restoring reserves to policy levels or as required by law. ~~[[In the event that]]~~ If the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities ~~[[such as Pension or Retiree Health Benefits Prefunding (OPEB)]]~~. Priority consideration should be given to unfunded liabilities for Retiree Health Benefits (OPEB) and Pension Benefits Prefunding.

4. Should all of the policy statements be restated as goals rather than requirements?

Action Clauses 4 and 5 are stated as mandatory requirements. The Council cannot adopt binding fiscal policies through a resolution of this nature. Binding fiscal policies should be established in County law. Therefore these action clauses should be reframed as goals rather than requirements, consistent with the remainder of the Resolution.

Council staff recommendation: amend Action Clauses 4 & 5 as follows:

4. PAYGO

The County ~~[[will]]~~ should allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.

5. Fiscal Plan

The County ~~[[will]]~~ should adopt a fiscal plan that is structurally balanced, and that displays expenditures and other uses of resources within annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.

Council staff notes that the adoption of a fiscal plan will follow logically after the Council acts on the Resolution and the Bill.

5. Would a policy of always funding the General Fund reserve at the 5% Charter maximum reduce the Council's authority to control use of the total reserve?

The total reserve is made up of the General Fund reserve and the RSF. The General Fund reserve can be used:

- a. To fund additional unbudgeted expenses, such as a major snow storm. The Executive cannot spend the General Fund reserve unless the Council approves a supplemental or special appropriation; or
- b. To offset a shortfall in revenue, such as occurred in FY10 with the income tax. In this case, no action by the Council is necessary to "use" this reserve.

The RSF can only be used to fund appropriated expenditures that have become unfunded due to a shortfall in revenue. The Council must approve any withdrawal of funds from the RSF. Therefore, once the budget is approved, the Council only has control over the portion of the total reserve in the RSF. The General Fund reserve can be used by the Executive to fund appropriated expenditures without Council approval. If most of the total reserve is in the General Fund reserve, the Council has less control over its use. One solution would be to establish a policy that the approved budget place at least 50% of the total reserve in the RSF.

If the County reaches the new 10% AGR target goal, more than 50% of the total reserve would be in the RSF since the 5% General Fund reserve is approximately 3.5% of the total reserve. However, while the County is ramping up to the 10% goal, a policy of placing 50% of the total reserve in the RSF would continue to provide the Council with significant control over the use of the total reserve. **Council staff recommendation:** add the following sentence after the second sentence in Action Clause 2:

The approved budget should place at least 50% of the total reserve in the Revenue Stabilization Fund.

As shown in ©40, this additional language would decrease the reserve in the General Fund and increase the reserve in the RSF by the same amount only in FY12 and FY13. Starting in FY14, the reserve in the General Fund would be at its maximum and the reserve in the RSF will account for more than half of the total reserve. As a result, the allocation of reserve would be the same starting in FY14 with or without this additional sentence.

Issues Related to the Bill

1. Should the definition in the Bill of Adjusted Governmental Revenue (AGR) be used?

The Bill would add, in §20-65, Definitions, a definition for Adjusted Governmental Revenue (AGR) to be used to calculate the mandatory contribution to the RSF. AGR would also be used as the base for calculating the target reserve under the Resolution. See lines 9-18 of the Bill at ©2. AGR would be the sum of:

- (1) Tax-supported County governmental funds revenues, plus revenues of the:
- (2) County Grants Fund;
- (3) County Capital Projects Fund;
- (4) Tax supported funds of the Montgomery County Public Schools, not including the County's local contribution;
- (5) Tax supported funds of Montgomery College, not including the County's local contribution; and
- (6) Tax supported funds of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission.

As stated above, Components 1 and 4 through 6 are the same as is currently used to calculate the amount of target reserve at 6%. Components 1 and 4 through 6 are listed separately in the definition of AGR to coincide with the accounting definitions used in the County's financial statements, but they represent the revenues in the 4 tax supported agencies. The second and third components are not currently used, but Finance staff recommend including them in the proposed new 10% goal because the County has to advance County cash and wait for collection or reimbursement for most of the revenue. Since the County has to advance County cash, the County needs some additional reserve to ensure that the cash is in the bank. The amount of the existing reserve at the beginning of the year is currently used to calculate the 6% target reserve, but would not be used to calculate the 10% target reserve under the proposed policy. **Council staff recommendation:** approve the definition of AGR as introduced in the Bill.

2. Should the Bill include a definition for excess revenue?

The Bill at lines 73-77 at ©4, uses the concept of excess revenue for determining the mandatory contribution to the RSF. Although the Bill clearly describes the use of the concept, a separate definition in the Bill would make it easier to use the concept in the Bill and corresponding fiscal policies. **Council staff recommendation:** add the following definition after line 25 at ©2:

Excess revenue means the amount, if positive, by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the fiscal year exceed the original projections for these amounts.

The term “original projection” is already defined in the law.

The mandatory contribution in §20-68 would be amended as follows:

Amend lines 67-77 as follows:

- (a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:
- (1) the annual percentage increase in the certified revenues projected for the next fiscal year, and
 - (2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of [[the]] any excess revenue [[amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts]]; or

3. Should the RSF have a maximum size?

The Bill would repeal the maximum size for the RSF contained in §20-67. As discussed earlier, the 10% of AGR goal in the Resolution would have resulted in \$163.1 million less spending or increased taxes in FY11. With the mandatory contributions to the RSF contained in the Bill and no cap, the RSF can grow larger with no control. As discussed earlier, Finance staff pointed out that the mandatory contribution to the RSF can only result in a target reserve greater than 10% of AGR by 50% of excess revenues under the Bill. If the Council decides to amend the Bill to keep a cap on total reserve, Finance staff would recommend that the maximum size be greater than the 10% target goal. Finance staff and the County’s financial advisor stated that a 10% reserve is roughly equal to only 36 days of cash on hand to pay the County’s operating expense, which is not enough. The GFOA notes that AAA rated counties should have at least 2 months, which would require a 17% reserve. A 3 month reserve would require a 25% reserve.

The County has some significant mandatory funding obligations. For example, almost 57% of the total combined FY11 agency expenditures are dedicated to the Montgomery County Public Schools (MCPS). Under the State Education Law, increases in State education funding are contingent on the County meeting its maintenance of effort (MOE) level or receiving a waiver from the State Board of Education. An oversized RSF could reduce the County’s ability to meet the MOE

level and also reduce the County's opportunity to receive a waiver from the State.¹ **Council staff recommendation:** amend the Bill to add a maximum size for the total reserve, which would be the sum of the RSF and the General Fund reserve.

Add the following definition after line 47 of the Bill at ©3.

Total reserve means the sum of the reserve in the Fund plus the Unrestricted General Fund Balance.

Council staff recommends that the maximum size of the budgeted total reserve be 25%.

Amend lines 54-63 at ©4 as follows:

20-67. [Fund sources and maximum size.] [[Reserved.]] Maximum size.

- (a) The Fund must not exceed 10 percent of the average aggregate annual revenue derived from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund in the 3 preceding fiscal years.
- (b) The Director must compute the maximum amount of the Fund annually and report that amount to the County Council not later than June 15.
- (c) The Fund is in addition to any surplus that may be accumulated under Section 310 of the County Charter.]

On the date the Council approves the operating budget, the estimated total reserve in the approved operating budget must not exceed 25% of the estimated Adjusted Governmental Revenues.

The 25% limit on total reserves would also need to be reflected in the mandatory contribution set forth in §20-68. **Council staff recommends** the following amendment:

Amend lines 65-82 at ©4-5 as follows:

[(a) Subject to the limit set in Section 20-67(a), the] ~~[[The]]~~ Subject to the limit in Section 20-67,
the mandatory annual contribution to the Fund must equal the greater of:

- (a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:

¹ The State's recent enactment of a new law mandating arbitration to resolve an impasse over the terms of a new collective bargaining agreement with school employee unions is likely to insert additional pressure on the County School Board to provide increased salary and benefits for school employees. See Senate Bill 590.

- (1) the annual percentage increase in the certified revenues projected for the next fiscal year, and
 - (2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of [[the]] any excess revenue [[amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts]]; or
- (b) an annual amount [[that does not exceed]] equal to the lesser of 0.5 percent of the actual Adjusted Governmental Revenues [[for the current year, but which does not result in the sum of the current year-end projected Unrestricted General Fund Balance and the Fund to exceed]] or an amount needed to obtain a total reserve of 10 percent of the Adjusted Governmental Revenues.

Since both mandatory contributions are based on actual revenues, the mandatory transfer for a fiscal year would be made as part of the year end closing process as is done under the current law.

The 25% ceiling on total reserves must also be reflected in §§20-69 and 20-70 as follows:

Amend lines 93-100 at ©5 as follows:

20-69. Discretionary contributions to Fund.

The County Executive may recommend and the County Council may by resolution approve additional contributions to the Fund [if doing so will not result in the 10 percent limit in Section 20-67(a) being exceeded] subject to the limit in Section 20-67.

20-70. Transfer of contributions.

The Director must transfer the mandatory contributions required by Section 20-68 and any discretionary contributions under Section 20-69 from the General [fund] Fund to the Fund at the end of each fiscal year, subject to the limit of Section 20-67.

If the Committee decides to approve the Executive's recommendation to remove the maximum size of the RSF, Council staff would recommend amending lines 65-82 to clarify the mandatory contribution in §20-68 as follows:

Amend lines 65-82 at ©4-5 as follows:

[(a) Subject to the limit set in Section 20-67(a), the] The mandatory annual contribution to the Fund must equal the greater of:

- (a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:
 - (1) the annual percentage increase in the certified revenues projected for the next fiscal year, and
 - (2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of
[[the]] any excess revenue [[amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts]]; or
- (b) an annual amount [[that does not exceed]] equal to the lesser of 0.5 percent of the actual Adjusted Governmental Revenues [[for the current year, but which does not result in the sum of the current year-end projected Unrestricted General Fund Balance and]] or the amount needed to obtain a total reserve [[the Fund to]] of [[exceed]] 10 percent of the Adjusted Governmental Revenues.

None of the recommended amendments to §§20-67, 20-69, or 20-70 would be necessary. The addition of a definition for “total reserve” would still be necessary.

4. Should the permitted uses of the Fund be clarified?

Council staff believes the conditions on using the Fund are unnecessarily complicated and restrictive. The current law requires certain economic triggers to occur before the Council can approve using the Fund by majority vote. However, current law also permits the Council to use the Fund without the economic triggers if approved by a supermajority of 6 Councilmembers. Eliminating the option to approve a transfer from the Fund by a simple majority of Councilmembers would both simplify the process and make it more difficult for the Council to approve a transfer from the Fund. **Council staff recommendation:** amend §20-72 as follows:

Amend lines 106-139 at ©6-7 as follows:

20-72. Use of Fund.

- [[a) After holding a public hearing and seeking the recommendation of the Executive, and if the Council finds that reasonable reductions in expenditures are not sufficient to offset the shortfall in revenue, the Council may by resolution approved by the Executive transfer an amount from the Fund to compensate for no more than half of the difference between the original projection of total General [fund] Fund revenues for that fiscal year and a revised forecast of the General Fund revenues projected for the same fiscal year. If the Executive disapproves a resolution within 10 days after it is transmitted and the Council readopts it by a vote of 6 Councilmembers, or if the Executive does not act within 10 days after it is transmitted, the resolution takes effect.]]
- [[b) However, a transfer must not be approved unless 2 of the following conditions are met:
- (1) The Director estimates that total General Fund revenues will fall more than 2 percent below the original projected revenues.
 - (2) Resident employment in the County has declined for 6 consecutive months compared to the same month in the previous year.
 - (3) The [local] most recent regional index of leading economic indicators, published by the Center for Regional Analysis, George Mason University, or a successor index determined by the Department of Finance, has declined for 3 consecutive months.]]
- [[c) The cumulative transfers from the Fund in any single fiscal year must not exceed half of the balance in the Fund at the start of that fiscal year.]]
- [[d) The funds transferred may only be used to support appropriations which have become unfunded.]]
- [[e)] By an affirmative vote of 6 Councilmembers, the Council, after holding a public hearing and seeking the recommendation of the Executive, may transfer [[amounts]] any amount from the Fund to the General Fund [[without regard to the limits and conditions in subsections (a)-(c)] to support appropriations which have become unfunded.

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Bill No. 36-10
Concerning: Finance – Revenue
Stabilization Fund – Amendments
Revised: May 25, 2010 Draft No. 2
Introduced: May 27, 2010
Expires: November 27, 2011
Enacted: _____
Executive: _____
Effective: _____
Sunset Date: None
Ch. _____, Laws of Mont. Co. _____

COUNTY COUNCIL FOR MONTGOMERY COUNTY, MARYLAND

By: Council President at the Request of the County Executive

AN ACT to:

- (1) repeal the limit on the size of the Revenue Stabilization Fund;
- (2) modify the requirement for mandatory County contributions to the Revenue Stabilization Fund; and
- (3) generally amend the law governing the Revenue Stabilization Fund.

By amending

Montgomery County Code
Chapter 20, Finance
Article XII
Sections 20-65, 20-66, 20-68, 20-69, 20-70, 20-71 and 20-72

By repealing

Montgomery County Code
Chapter 20, Finance
Article XII
Section 20-67

Boldface	<i>Heading or defined term.</i>
<u>Underlining</u>	<i>Added to existing law by original bill.</i>
[Single boldface brackets]	<i>Deleted from existing law by original bill.</i>
<u>Double underlining</u>	<i>Added by amendment.</i>
[[Double boldface brackets]]	<i>Deleted from existing law or the bill by amendment.</i>
* * *	<i>Existing law unaffected by bill.</i>

The County Council for Montgomery County, Maryland approves the following Act:

Sec. 1. Sections 20-65, 20-66, 20-68, 20-69, 20-70, 20-71 and 20-72 are amended and Section 20-67 is repealed as follows:

20-65. Definitions.

In this Article the following terms have the following meanings, unless the context clearly indicates a different meaning:

[(a)] *Actual total revenues* means the combined total of income tax, real property transfer tax, recordation tax, and investment income, as reported in the County's annual financial report.

Adjusted Governmental Revenues means tax-supported County Governmental Funds revenues, plus revenues of the:

(1) County Grants Fund;

(2) County Capital Projects Fund;

(3) tax supported funds of the Montgomery County Public Schools, not including the County's local contribution;

(4) tax supported funds of Montgomery College, not including the County's local contribution; and

(5) tax supported funds of the Montgomery County portion of the Maryland-National Capital Park and Planning Commission.

[(b)] *Certified revenues* means revenues derived each fiscal year from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund as certified by the Director on or before June 15.]

[(c)] *Debt Service Fund* means the fund used to accumulate funds to pay general long-term debt principal, interest and related costs.]

[(d)] *Director* means the Director of the Department of Finance.

[(e)] *Fund* means the Revenue Stabilization Fund created under this Article.

28 [(f)] *General Fund* means the general operating fund of the County which
 29 is used to account for all revenues and expenditures, except revenues
 30 and expenditures required to be accounted for in another fund.

31 [(g)] *Income tax* means the County income tax imposed under state law.

32 [(h)] *Investment income of the General Fund* means income from the
 33 investment of revenues that is reported in the General Fund.

34 [(i)] *Original projection* means the projection of total General Fund
 35 revenues for the next fiscal year approved by the County Council in
 36 the "Schedule of Revenue Estimates and Appropriations" resolution
 37 or any similar resolution.

38 [(j)] *Real property transfer tax* means the tax imposed under Sections 51-
 39 19 et. seq.

40 [(k)] *Recordation tax* means the tax imposed under Sections 12-101 et.
 41 seq., Tax-Property Article, [Annotated Code of] Maryland Code.

42 [(l)] *Revised forecast* means any revised projection of total General Fund
 43 revenues for the next fiscal year prepared by the Department of
 44 Finance.

45 Unrestricted General Fund Balance means the residual portion of the
 46 General Fund fund balance that has not been reserved, restricted, or
 47 encumbered for later years' expenditures.

48 **20-66. Revenue Stabilization Fund.**

49 (a) The Director may establish a Revenue Stabilization Fund to support
 50 appropriations which have become unfunded.

51 (b) The Fund is continuing and non-lapsing.

52 (c) The Fund is in addition to any surplus that is accumulated under
 53 Section 310 of the County Charter.

20-67. [Fund sources and maximum size.] Reserved.

[(a) The Fund must not exceed 10 percent of the average aggregate annual revenue derived from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund in the 3 preceding fiscal years.

(b) The Director must compute the maximum amount of the Fund annually and report that amount to the County Council not later than June 15.

(c) The Fund is in addition to any surplus that may be accumulated under Section 310 of the County Charter.]

20-68. Mandatory contribution to Fund.

[(a) Subject to the limit set in Section 20-67(a), the] The mandatory annual contribution to the Fund must equal the greater of:

(a) [50 percent of the product of the certified revenues estimated for the current fiscal year times the difference between:

(1) the annual percentage increase in the certified revenues projected for the next fiscal year, and

(2) the average annual percentage increase in the certified revenues collected in the 6 fiscal years immediately preceding the next fiscal year.] 50 percent of the amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projections for these amounts; or

(b) an annual amount that does not exceed 0.5 percent of the Adjusted Governmental Revenues for the current year, but which does not

80 result in the sum of the current year-end projected Unrestricted
 81 General Fund Balance and the Fund to exceed 10 percent of the
 82 Adjusted Governmental Revenues.

83 [(b) A growth or decline in certified revenues which results from either an
 84 increase or decrease in County tax rates must be:

- 85 (1) excluded from revenues projected for the next fiscal year, and
- 86 (2) phased in in the average annual percentage increase calculation
- 87 in the third, fourth, fifth and sixth years.

88 (c) If actual total revenues from the income tax, real property transfer tax,
 89 recordation tax, and investment income of the General Fund for the
 90 next fiscal year exceed the original projection, then 50 percent of the
 91 excess must be transferred to the Fund if doing so will not result in the
 92 10 percent limit in Section 20-67(a) being exceeded.]

93 **20-69. Discretionary contributions to Fund.**

94 The County Executive may recommend and the County Council may by
 95 resolution approve additional contributions to the Fund [if doing so will not result
 96 in the 10 percent limit in Section 20-67(a) being exceeded].

97 **20-70. Transfer of contributions.**

98 The Director must transfer the mandatory contributions required by Section
 99 20-68 and any discretionary contributions under Section 20-69 from the General
 100 [~~fund~~] Fund to the Fund at the end of each fiscal year.

101 **20-71. Interest.**

102 All interest earned on the Fund must be added to the Fund. [However, the
 103 Director must transfer interest earned on the Fund when the Fund exceeds 50
 104 percent of the maximum Fund size authorized by Section 20-67(a) to the Debt
 105 Service Fund as an offset to the approved issuance of general obligation debt.]

20-72. Use of Fund.

(a) After holding a public hearing and seeking the recommendation of the Executive, and if the Council finds that reasonable reductions in expenditures are not sufficient to offset the shortfall in revenue, the Council may by resolution approved by the Executive transfer an amount from the Fund to compensate for no more than half of the difference between the original projection of total General [fund] Fund revenues for that fiscal year and a revised forecast of the General Fund revenues projected for the same fiscal year. If the Executive disapproves a resolution within 10 days after it is transmitted and the Council readopts it by a vote of 6 Councilmembers, or if the Executive does not act within 10 days after it is transmitted, the resolution takes effect.

(b) However, a transfer must not be approved unless 2 of the following conditions are met:

- (1) The Director estimates that total General Fund revenues will fall more than 2 percent below the original projected revenues.
- (2) Resident employment in the County has declined for 6 consecutive months compared to the same month in the previous year.
- (3) The [local] most recent regional index of leading economic indicators, published by the Center for Regional Analysis, George Mason University, or a successor index determined by the Department of Finance, has declined for 3 consecutive months.

(c) The cumulative transfers from the Fund in any single fiscal year must not exceed half of the balance in the Fund at the start of that fiscal year.

(d) The funds transferred may only be used to support appropriations which have become unfunded.

(e) By an affirmative vote of 6 Councilmembers, the Council, after holding a public hearing and seeking the recommendation of the Executive, may transfer amounts from the Fund without regard to the limits and conditions in subsections (a)-(c).

Approved:

Nancy M. Floreen, President, County Council

Date

Approved:

Isiah Leggett, County Executive

Date

This is a correct copy of Council action.

Linda M. Lauer, Clerk of the Council

Date

LEGISLATIVE REQUEST REPORT

Bill 36-10

Revenue Stabilization Fund - Amendments

DESCRIPTION:	The requested legislation removes the cap from the Revenue Stabilization Fund (RSF), retains interest earned in the RSF, and requires mandatory contributions to the RSF to achieve total reserves of 10%.
PROBLEM:	The legislation would help ensure adequate reserve levels by increasing them to 10% over the next ten, or fewer, years.
GOALS AND OBJECTIVES:	This legislation, along with the accompanying "Reserve and Selected Fiscal Policies" Resolution is designed to strengthen the County's fiscal health, by improving budgetary flexibility and building reserve levels.
COORDINATION:	Department of Finance; Office of Management and Budget
FISCAL IMPACT:	To be requested.
ECONOMIC IMPACT:	To be requested.
EVALUATION:	To be requested.
EXPERIENCE ELSEWHERE:	To be researched.
SOURCE OF INFORMATION:	Jennifer Barrett, Director, Department of Finance Joseph Beach, Director, Office of Management and Budget Kathleen Boucher, Assistant Chief Administrative Officer
APPLICATION WITHIN MUNICIPALITIES:	N/A
PENALTIES:	N/A



OFFICE OF THE COUNTY EXECUTIVE
ROCKVILLE, MARYLAND 20850

Isiah Leggett
County Executive

MEMORANDUM

May 21, 2010

TO: Nancy Floreen, President, County Council

FROM: Isiah Leggett, County Executive

SUBJECT: Reserve and Selected Fiscal Policies

In my April 22nd memorandum to the Council on Additional Budget Actions, I notified the Council of the need for revisions to the County's reserve policies. I made this recommendation in light of recent severe reductions in revenues, unanticipated expenditure pressures, and Moody's rating action putting the County on a negative watchlist. All three rating agencies included strong statements of concern regarding the County's reserves and budgetary structural balance in their most recent ratings.

As I indicated to you in April, I have asked for and received a careful review of the County's reserve policies by the County's Financial Advisor, PFM. As a result of that review, I am recommending a set of actions and policies which will set the County on a stronger fiscal path for FY11 and beyond. Attached to this memorandum you will find a resolution specifying these policies for Council's consideration and action, legislation to change the County's Revenue Stabilization Fund law, and a restructured balanced Fiscal Plan showing budgetary levels afforded within projected revenues and my plan for restoration of the County's key reserves to the recommended policy levels.

Specifically, the recommended reserve levels incorporate current and future risks, including:

- Potential for future State actions which may negatively affect the County's revenues and/or place additional expenditure requirements on the County.
- Numerous one-time actions taken to solve the FY10 and FY11 budget challenges.

Recommended Actions

The attached charts (Attachments A and B) provide background on the current status of the County's most key fiscal policies, detailing the recommendations I made to you in April, and those that I am making today. In addition, I will soon be transmitting to you a report from the County's Financial Advisor, PFM, that provides further analysis and detail on the concerns of Moody's and the other Rating Agencies, and the fiscal circumstances that support the need for the recommended actions.

Specifically, I am recommending the following policies and actions, which are further detailed in the attachments:

1. For FY11, budget reserves at the current policy level of 6%, and within 10 years (by 2020), bring total reserves to 10%
2. Bring General Fund reserves to the charter maximum of 5%
3. Require mandatory contributions to the Revenue Stabilization Fund to a combined reserve level of 10%
4. Restore and maintain PAYGO at the policy level of 10% of general obligation bonds planned for issue
5. Budget expenditures for a fiscal year only up to the amount of recurring revenues for that fiscal year
6. Direct one-time revenues exceeding projections to the Revenue Stabilization Fund, PAYGO, Pension or Retiree's Health Benefit pre-funding, and one-time expenditures
7. Achieve a fiscal plan for future years that is structurally balanced – that matches expenditures to available revenues without any draw down of reserves or unanticipated revenues
8. Review budgeting practices for significant, known expenditures, and ensure adequacy of appropriations and possible carry-over provisions for unspent amounts

The combination of these actions is estimated to achieve structural budgetary balance and grow reserve levels to 10% by 2020 or sooner, enough to sustain the County through a variety of the pressures noted above. The reserve amounts I am recommending will also help ensure sufficient working capital through the County's usual fiscal cycle.

I very strongly recommend restoring General Fund reserves to the maximum allowed Charter level, and planning for a series of mandatory contributions to the Revenue Stabilization Fund to achieve a total reserve level of 10%. I recommend we strengthen our policies regarding a balanced budget and use of one-time revenues, and commit to return to our existing PAYGO policy. This set of actions will provide additional flexibility to the County in FY12 and beyond to respond to further adverse economic and fiscal conditions.

Nancy Floreen, Council President
May 21, 2010
Page 3

These actions are only the beginning of the work before us. I believe that together, we must steer the County back to structurally balanced budgets and return it to its fiscally conservative roots, restoring sufficiently strong reserve levels, to ensure that we do not return to the budget stresses we currently face. I believe the set of recommendations before you will ensure that outcome, and I urge your approval.

Enclosures

Attachment A – Reserve Policies – Overview
Attachment B – Comparison of Fiscal Policies and Practices
Resolution – Reserve and Selected Fiscal Policies
Draft Bill - Revenue Stabilization Fund
Restructured Balanced Fiscal Plan – FY11-16

cc: Duchy Trachtenberg, Chair, MFP Committee
Timothy Firestine, Chief Administrative Officer
Jennifer Barrett, Director of Finance
Joseph Beach, Director, OMB
Stephen Farber, Council Staff Director
Kathleen Boucher, ACAO

ATTACHMENT A

RESERVE POLICIES – OVERVIEW

1. CURRENT POLICIES

Balanced Budget: expenditures not to exceed resources (including prior year ending fund balance)
Reserves: 6% of combined all tax supported (including outside agencies) and revenue stabilization fund (RSF)
RSF: mandatory contribution up to cap, investment earnings go to PAYGO
PAYGO: 10% of planned GO Bond issues
One Time Revenues: whenever possible give highest priority to capital assets or other non-recurring expenditures

2. APRIL 22nd MEMORANDUM

Balanced Budget: budgeted expenditures should match new revenues projected to occur in that fiscal year
Reserves: 6% for FY11 and ramp up to 8% by end of FY13
General Fund (GF) at Charter Limit – 5% of prior year GF revenues
RSF: mandatory contributions to RSF to 3% (total of 8%), remove cap
PAYGO: restore and maintain at 10% policy level
One Time Revenues: direct in priority order to RSF, PAYGO, Retiree Health pre-funding, and one-time expenditures
Fiscal Plan: achieve a fiscal plan display that is structurally balanced consistent with balanced budget policy

3. RECOMMENDED – PFM MAY 2010

Balanced Budget: expenditures not to exceed revenues
Reserves: 6% for FY11, then ramp up combined General Fund and RSF balances over ten years to 10% of adjusted governmental revenues—
RSF: mandatory contributions up to 10% reserve policy, remove cap, investment earnings retained in RSF
PAYGO: 10% of planned GO Bond issues
One Time Revenues: applied first to restoring reserves to policy levels or as required by law. If reserves have been fully funded, then one-time revenues should be applied to expenditures which are one-time in nature, PAYGO in excess of the County's targeted goal, or to unfunded liabilities such as Pension or OPEB

ATTACHMENT B

COMPARISON OF FISCAL POLICIES AND PRACTICES – CURRENT POLICY/PRACTICE vs. RECOMMENDED

	CURRENT POLICY/PRACTICE	PFM and FINANCE RECOMMENDED POLICIES
Structurally Balanced Budget	<p>Current Fiscal Policy:</p> <p><i>It is the fiscal policy of Montgomery County to balance the budget. A balanced budget has its funding sources (revenues, undesignated carryover, and other resources) equal to its funding uses (expenditures, reserves, and other allocations). No deficit may be planned or incurred.</i></p>	<p>Recommended Policy:</p> <p><i>Montgomery County will have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.</i></p>
Reserves	<p>Current Fiscal Policy:</p> <p><i>The County will maintain total reserves for tax supported funds that include both an operating margin reserve and the RSF. For tax supported funds, the budgeted total reserve of the operating margin and the RSF should be at least 6.0 percent of total resources (i.e., revenues, transfers, prior year undesignated and designated fund balance).</i></p>	<p>Recommended Policy:</p> <p><i>Montgomery County will have a goal over 10 years (by 2020) of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund to an amount equal to approximately 10% of Adjusted Governmental Fund revenues.</i></p> <p>Higher reserves are recommended in keeping with:</p> <ol style="list-style-type: none"> 1) revenue volatility 2) expenditure volatility 3) working capital needs 4) more in line with other large AAA jurisdictions
General Fund Reserves	<p>Section 310 of Charter:</p> <p><i>With respect to the General Fund, any unappropriated surplus shall not exceed five percent of the General Fund revenue for the preceding fiscal year.</i></p>	<p>Retain, but policy reserves above Charter limitation will be included in target for RSF.</p>

ATTACHMENT B (continued)

<p>Revenue Stabilization Fund (RSF)</p>	<p>RSF is currently capped at 10% of average of prior 3 years specific revenue sources. Interest earned is transferred to PAYGO, and mandatory contributions are based on revenues exceeding estimates. (See County Code Ch 20 Article XII)</p> <p>If actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection, then 50 percent of the excess must be transferred to the Fund.</p>	<p>Remove cap, retain interest earned in RSF, and require mandatory contributions to achieve total reserves of 10% and when revenues exceed estimates:</p> <p>Mandatory annual contributions to the Fund must equal the greater of:</p> <p>50 percent of the amount by which actual total revenues from the income tax, real property transfer tax, recordation tax, and investment income of the General Fund for the next fiscal year exceed the original projection for these amounts.</p> <p>An annual amount not to exceed 0.5 percent of the Adjusted Governmental Revenues for the current year, but which does not result in the sum of the current year-end projected Unrestricted General Fund fund balance and the Revenue Stabilization Fund to exceed 10 percent of the Adjusted Governmental Revenues.</p>
<p>Use of One-time Revenues</p>	<p>Current Fiscal Policy:</p> <p>Except for excess revenues which must go to the Revenue Stabilization Fund, the County will, whenever possible, give highest priority for the use of one-time revenues from any source to the funding of capital assets or other nonrecurring expenditures so as not to incur ongoing obligations for which revenues may not be adequate in future years.</p>	<p>Recommended Policy:</p> <p>One-time revenues and revenues in excess of projections will be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or OPEB.</p>

ATTACHMENT B (continued)

PAYGO	<p>Current CIP Fiscal Policy:</p> <p><i>It is the County's policy to allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.</i></p>	<p>Recommended Policy: (unchanged)</p> <p><i>The County will allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.</i></p>
Fiscal Plan	<p>Shows Resources and Uses balanced in the budget year. To the extent uses exceed resources in future years, deficit amounts are displayed as Gaps to be closed in future budgets.</p>	<p>Recommended Policy:</p> <p><i>The County will adopt a fiscal plan that is structurally balanced, and that displays expenditures and other uses of resources within annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.</i></p>
Adequacy of budget appropriations	<p>Minimal levels are budgeted for certain known expenditures, not in line with actual experience.</p>	<p>Budget at more realistic levels, possibly in a separate account where unused balance can carry over to next year.</p>

County Executive's Recommended FY11-16 Public Services Program

(\$ in Millions)															
	App. FY10	Est. FY10	% Chg. FY10-11	App. FY11	% Chg. FY11-12	Projected FY12	% Chg. FY12-13	Projected FY13	% Chg. FY13-14	Projected FY14	% Chg. FY14-15	Projected FY15	% Chg. FY15-16	Projected FY16	
	5-21-09	5-27-10	Ret/Bud	5-27-10											
Total Revenues															
1	Property Tax (less PDs)	1,440.9	1,437.8	0.6%	1,450.1	2.7%	1,489.9	3.0%	1,534.9	3.1%	1,582.6	3.4%	1,635.9	2.4%	1,675.3
2	Income Tax	1,214.8	1,026.3	-12.7%	1,060.7	6.6%	1,130.2	6.2%	1,200.8	5.3%	1,264.8	8.6%	1,373.6	7.9%	1,482.6
3	Transfer/Record. Tax	123.4	114.8	13.4%	139.9	6.0%	148.3	-2.2%	145.1	8.7%	157.8	7.5%	169.7	5.1%	178.3
4	Investment Income	5.9	1.3	-38.2%	3.6	88.3%	6.9	95.1%	13.4	28.0%	17.1	16.8%	20.0	8.8%	21.7
5	Other Taxes	185.3	201.0	69.0%	313.2	2.8%	322.1	-32.8%	216.4	2.9%	222.6	2.8%	228.9	2.7%	235.1
6	Other Revenues	834.6	832.6	-2.8%	811.6	-2.5%	791.7	0.7%	797.2	0.7%	803.1	0.8%	809.6	0.9%	816.6
7	Total Revenues	3,804.9	3,613.9	-0.7%	3,779.2	2.9%	3,889.1	0.5%	3,907.8	3.6%	4,048.0	4.7%	4,237.6	4.1%	4,409.6
8															
9	Net Transfers In (Out)	37.2	62.1	12.0%	41.7	-68.0%	13.4	2.4%	13.7	2.6%	14.0	2.8%	14.4	3.0%	14.9
10	Total Revenues and Transfers Available	3,842.2	3,676.0	-0.6%	3,820.9	2.1%	3,902.4	0.5%	3,921.4	3.6%	4,062.0	4.7%	4,252.0	4.1%	4,424.4
11															
12	Non-Operating Budget Use of Revenues														
13	Debt Service	251.5	243.8	5.0%	264.0	11.9%	295.3	11.3%	328.6	8.3%	356.1	6.3%	378.5	4.6%	396.1
14	PAYGO	1.3	0.3	-100.0%	-	n/a	32.5	0.0%	32.5	0.0%	32.5	0.0%	32.5	0.0%	32.5
15	CIP Current Revenue	30.7	20.9	-22.6%	23.8	72.1%	40.9	40.3%	57.4	41.0%	81.0	3.9%	84.2	-24.7%	63.4
16	Montgomery College Reserves						4.0	1.9%	4.0	1.8%	4.1	1.8%	4.2	1.9%	4.3
17	MNCPPC Reserves						4.3	3.7%	4.5	3.5%	4.6	3.6%	4.8	2.6%	4.9
18	Contribution to General Fund Undesignated Reserves	(39.3)	(82.3)	372.2%	107.1	-100.4%	(0.4)	1498.5%	5.4	-119.9%	(1.1)	668.3%	6.1	39.3%	8.5
19	Contribution to Revenue Stabilization Reserves	-	(59.3)	n/a	33.9	-28.5%	24.3	-16.0%	20.4	16.4%	23.7	44.9%	34.4	-6.3%	32.2
20	Retiree Health Insurance Pre-Funding	-	-	n/a	-	n/a	83.6	22.7%	102.6	18.6%	121.7	14.9%	139.8	5.0%	146.8
21	Set Aside for other uses (supplemental appropriations)	2.5	60.1	-90.2%	0.3	8916.1%	22.5	0.0%	22.5	0.0%	22.5	-11.3%	20.0	0.0%	20.0
22	Total Other Uses of Resources	246.7	183.6	73.9%	429.1	18.2%	507.1	14.0%	578.0	11.6%	645.2	9.2%	704.4	0.6%	708.5
23	Available to Allocate to Agencies (Total Revenues+Net Transfers-Total Other Uses)	3,595.4	3,492.4	-5.7%	3,391.8	0.1%	3,395.3	-1.5%	3,343.4	2.2%	3,416.9	3.8%	3,547.7	4.7%	3,715.9
24															
25	Agency Uses														
26															
27	Montgomery County Public Schools (MCPS)	2,020.1	1,989.9	-5.0%	1,919.8	0.3%	1,926.240	-1.3%	1,901.5	2.4%	1,947.9	4.1%	2,027.1	5.0%	2,127.9
28	Montgomery College (MC)	217.5	214.5	-0.8%	215.8	1.0%	217.853	-0.6%	216.5	3.1%	223.3	4.7%	233.8	5.6%	247.0
29	MNCPPC (w/o Debt Service)	106.6	103.2	-13.1%	92.7	-1.4%	91.331	-3.2%	88.4	0.6%	88.9	2.2%	90.9	3.2%	93.8
28	MCG	1,251.2	1,184.8	-7.0%	1,163.6	-0.3%	1,159.870	-2.0%	1,136.9	1.7%	1,156.8	3.4%	1,195.9	4.3%	1,247.3
29	Subtotal Agency Uses	3,595.4	3,492.4	-5.7%	3,391.8	0.1%	3,395.3	-1.5%	3,343.4	2.2%	3,416.9	3.8%	3,547.7	4.7%	3,715.9
30	Total Uses	3,842.2	3,676.0	-0.6%	3,820.9	2.1%	3,902.4	0.5%	3,921.4	3.6%	4,062.0	4.7%	4,252.0	4.1%	4,424.4
31	(Gap)/Available	0.000	0.000		0.0000000		0.000		0.000		0.000		0.000		0.000

Notes:

1. FY12-16 property tax revenues are at the Charter Limit assuming a tax credit. All other tax revenues at current rates except as noted below.
2. Revenues reflect Energy Tax and Wireless Telephone Tax increases approved by the County Council on May 27, 2010. Energy Tax increase sunsets at the end of FY12.
3. PAYGO restored to policy level of 10% of planned GO Bond borrowing in FY12-16. See Row 14 above.
4. FY11 Revenues reflect one year redirection of Recordation Tax Premium (\$8 M.) and Recordation Tax for MCPS CIP and College IT (\$5 M.).
5. Retiree Health Insurance Pre-Funding assumed to resume at scheduled contribution levels in FY12. See Row 20 above.
6. Projected FY12-16 rate of growth of Agency Uses constrained to balance the fiscal plan in FY12-16.
7. FY11 Reserves reflect restoration of reserves to current 6% (of tax supported resources) policy level. FY10 and FY11 reserves (see Rows 34-42 below) include all County and Outside Agency tax supported reserves.
8. FY12-16 Unrestricted General Fund Reserves are reduced in certain years to reflect compliance with Section 310 of the County Charter on maximum size of the general fund balance (shall not exceed 5% of prior year general fund revenues). Outside Agency reserves are excluded from these amounts and are displayed separately (see Rows 29 and 30 above).
9. FY12-16 Reserves reflect proposed new reserve policy including increase in reserve levels and inclusion of capital projects and grant revenues as part of Adjusted Governmental Revenues.

County Executive's Recommended FY11-16 Public Services Program

(\$ in Millions)

	App. FY10	Est. FY10	% Chg. FY10-11	Rec. FY11	% Chg. FY11-12	Projected FY12	% Chg. FY12-13	Projected FY13	% Chg. FY13-14	Projected FY14	% Chg. FY14-15	Projected FY15	% Chg. FY15-16	Projected FY16
Beginning Reserves														
Unrestricted General Fund	115.5	112.0	-74.3%	29.7	360.4%	136.8	-0.3%	136.4	3.9%	141.8	-0.8%	140.7	4.3%	146.8
Revenue Stabilization Fund	119.6	119.6	-49.5%	60.4	56.2%	94.3	25.7%	118.6	17.2%	139.0	17.1%	162.7	21.1%	197.1
Total Reserves	235.2	231.6	-61.7%	90.1	156.5%	231.1	10.3%	255.0	10.1%	280.7	8.1%	303.4	13.3%	343.9
Additions to Reserves														
Unrestricted General Fund	-39.3	-82.3	372.2%	107.1	-100.4%	-0.4	1498.5%	5.4	-119.9%	-1.1	668.3%	6.1	39.3%	8.5
Revenue Stabilization Fund	0.0	-59.3	n/a	33.9	-28.5%	24.3	-16.0%	20.4	16.4%	23.7	44.9%	34.4	-6.3%	32.2
Total Change in Reserves	-39.3	-141.5	-458.4%	141.0	-83.1%	23.9	7.9%	25.8	-12.1%	22.6	78.6%	40.5	0.5%	40.7
Ending Reserves														
Unrestricted General Fund	76.2	29.7	79.5%	136.8	-0.3%	136.4	3.9%	141.8	-0.8%	140.7	4.3%	146.8	5.8%	155.3
Revenue Stabilization Fund	119.6	60.4	-21.2%	94.3	25.7%	118.6	17.2%	139.0	17.1%	162.7	21.1%	197.1	16.3%	229.2
Reserves as a % of Total Tax Supported Revenues Plus CIP & Operating Grant Revenues	195.8	90.1	18.0%	231.1	10.3%	255.0	10.1%	280.7	8.1%	303.4	13.3%	343.9	11.8%	384.5
				6.0%		6.3%		6.9%		7.2%		7.8%		8.4%
Retiree Health Insurance Pre-Funding														
Montgomery County Public Schools (MCPS)				-		53.2		64.8		76.4		87.7		92.1
Montgomery College (MC)				-		1.0		1.2		1.3		1.4		1.5
MNCPPC (w/o Debt Service)				-		4.4		5.1		5.6		6.1		6.4
MCG				-		25.0		31.5		38.4		44.6		46.8
Subtotal Retiree Health Insurance Pre-Funding				-	-	83.6	-	102.6	-	121.7	-	139.8	-	146.8

FY11-16 Tax Supported Fiscal Plan Summary (Current 6% Reserve Policy)

(\$ in Millions)

	App. FY10	Est. FY10	% Chg. FY10-11 Rec/Bud	App. FY11	% Chg. FY11-12	Projected FY12	% Chg. FY12-13	Projected FY13	% Chg. FY13-14	Projected FY14	% Chg. FY14-15	Projected FY15	% Chg. FY15-16	Projected FY16
Total Resources	5-21-09	5-27-10		5-27-10										
Revenues	3,804.9	3,613.9	-0.7%	3,779.2	2.9%	3,889.1	0.5%	3,907.8	3.6%	4,048.0	4.7%	4,237.6	4.1%	4,409.6
Beginning Reserves Undesignated	115.5	112.0	-74.3%	29.7	360.4%	136.8	8.2%	148.0	1.2%	149.8	5.7%	158.4	7.5%	170.3
Beginning Reserves Designated	-	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-
Net Transfers In (Out)	37.2	62.1	12.0%	41.7	-68.0%	13.4	2.4%	13.7	2.6%	14.0	2.8%	14.4	3.0%	14.9
Total Resources Available	3,957.7	3,788.0	-2.7%	3,850.6	4.9%	4,039.2	0.7%	4,069.5	3.5%	4,211.9	4.7%	4,410.4	4.2%	4,594.7
Less Other Uses of Resources (Capital, Debt Service, Reserve)	362.2	295.6	26.7%	458.8	17.6%	539.3	9.6%	591.0	10.1%	650.5	5.4%	685.4	1.1%	693.3
Available to Allocate to Agencies	3,595.4	3,492.4	-5.7%	3,391.8	3.2%	3,499.8	-0.6%	3,478.5	2.4%	3,561.4	4.6%	3,725.0	4.7%	3,901.5
Agency Uses														
Montgomery County Public Schools (MCPS)	2,020.1	1,989.9	-5.0%	1,919.8	0.9%	1,938.1	-0.9%	1,920.0	2.1%	1,960.9	4.5%	2,048.4	5.0%	2,150.0
Montgomery College (MC)	217.5	214.5	-0.8%	215.8	1.6%	219.2	-0.3%	218.6	2.8%	224.7	5.1%	236.2	5.6%	249.5
MNCPPC (w/o Debt Service)	106.6	103.2	-13.1%	92.7	-0.8%	91.9	-2.8%	89.3	0.2%	89.5	2.6%	91.9	3.1%	94.8
MCG	1,251.2	1,184.8	-7.0%	1,163.6	0.3%	1,167.0	-1.6%	1,148.0	1.4%	1,164.5	3.8%	1,208.6	4.3%	1,260.4
Subtotal Agency Uses	3,595.4	3,492.4	-5.7%	3,391.8	0.7%	3,416.2	-1.2%	3,375.9	1.9%	3,439.7	4.2%	3,585.2	4.7%	3,754.7
Retiree Health Insurance Pre-Funding														
Montgomery County Public Schools (MCPS)	-	-	-	-	-	53.2	-	64.8	-	76.4	-	87.7	-	92.1
Montgomery College (MC)	-	-	-	-	-	1.0	-	1.2	-	1.3	-	1.4	-	1.5
MNCPPC (w/o Debt Service)	-	-	-	-	-	4.4	-	5.1	-	5.6	-	6.1	-	6.4
MCG	-	-	-	-	-	25.0	-	31.5	-	38.4	-	44.6	-	46.8
Subtotal Retiree Health Insurance Pre-Funding	-	-	-	-	-	83.6	-	102.6	-	121.7	-	139.8	-	146.8
Subtotal Other Uses of Resources (Capital, Debt Service, Reserve)	362.2	295.6	26.7%	458.8	17.6%	539.3	9.6%	591.0	10.1%	650.5	5.4%	685.4	1.1%	693.3
Total Uses	3,957.7	3,788.0	-2.7%	3,850.6	4.9%	4,039.2	0.7%	4,069.5	3.5%	4,211.9	4.7%	4,410.4	4.2%	4,594.7
(Gap)/Available	-	-		-		-		-		-		-		-

Notes:

1. FY12-16 property tax revenues are at the Charter Limit assuming a tax credit. All other tax revenues at current rates except as noted below.
2. Revenues reflect Energy Tax and Wireless Telephone Tax increases approved by the County Council on May 27, 2010. Energy Tax increase sunsets at the end of FY12.
3. PAYGO restored to policy level of 10% of planned GO Bond borrowing in FY12-16.
4. FY11 Revenues reflect one year redirection of Recordation Tax Premium (\$8 M.) and Recordation Tax for MCPS CIP and College IT (\$5 M.).
5. Retiree Health Insurance Pre-Funding assumed to resume at scheduled contribution levels in FY12.
6. Projected FY12-16 rate of growth of Agency Uses constrained to balance the fiscal plan in FY12-16.
7. Reserves are reflected at the current policy level of 6% of total resources in FY11-16.

Resolution No: _____
Introduced: May 27, 2010
Adopted: _____

**COUNTY COUNCIL
FOR MONTGOMERY COUNTY, MARYLAND**

By: Council President at the Request of the County Executive

SUBJECT: Reserve and Selected Fiscal Policies

Background

1. Fiscal policy corresponds to the combined practices of government with respect to revenues, expenditures, debt management, and reserves.
2. Fiscal policies provide guidance for good public practice in the planning of expenditures, revenues, and funding arrangements for public services. They provide a framework within which budget, tax, and fee decisions should be made. Fiscal policies provide guidance toward a balance between program expenditure requirements and available sources of revenue to fund them.
3. As a best practice, governments must maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning. Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness.
4. In FY10, the County experienced an unprecedented \$265 million decline in income tax revenues, and weathered extraordinary expenditure requirements associated with the H1N1 flu virus and successive and historic winter blizzards. The costs of these events totaled in excess of \$60 million, only a portion of which was budgeted and planned for.
5. In a memorandum dated April 22, 2010, the County Executive recommended that the County Council restore reserves first to the current 6% policy level for FY11 and also to revise and strengthen policy levels in order to more appropriately position the County to weather economic cycles in the future, and to achieve structural balance in future budgets.
6. The County's financial advisor has recommended that the County strengthen its policy on reserves and other fiscal policies to ensure budget flexibility and structural stability, and has provided specific recommendations, which are reflected below.

Action

The County Council for Montgomery County, Maryland, approves the following policies regarding reserves and other fiscal matters:

1. Structurally Balanced Budget

Montgomery County must have a structurally balanced budget, that is, budgeted expenditures should not exceed projected recurring revenues for that fiscal year. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred.

2. Reserves

Montgomery County must have a goal of building up and maintaining the sum of Unrestricted General Fund Balance and Revenue Stabilization Fund Balance to an amount equal to approximately 10% of Adjusted Governmental Fund revenues, representing tax-supported governmental and agency revenues, including operating grant and CIP revenues. This goal must be reflected in the Revenue Stabilization Fund law.

3. Use of One-Time Revenues

One-time revenues and revenues in excess of projections must be applied first to restoring reserves to policy levels or as required by law. In the event that the County determines that reserves have been fully funded, then one-time revenues should be applied to non-recurring expenditures which are one-time in nature, PAYGO for the CIP in excess of the County's targeted goal, or to unfunded liabilities such as Pension or Retiree Health Benefits Pre-funding (OPEB).

4. PAYGO

The County must allocate to the CIP each fiscal year as PAYGO at least ten percent of the amount of general obligation bonds planned for issue that year.

5. Fiscal Plan

The County must adopt a fiscal plan that is structurally balanced, and that limits expenditures and other uses of resources to annually available revenues. The fiscal plan should also separately display reserves at policy levels, including additions to reserves to reach policy level goals.

This is a correct copy of Council action.

Linda M. Lauer, Clerk of the Council

	A	B	C	D
1	RESERVE, PROPOSED NEW POLICY, May 2010			
2	How is the target reserve calculated in the old 6% policy and in the new 10% policy?			
3				
4		Old 6% policy	New 10% policy	
5	Revenue in the 4 tax supported agencies	3,779.2	3,779.2	
6	Net transfers in	41.7	NA	
7	Beginning total reserve	90.1	NA	
8	County grants fund	NA	113.0	
9	County capital projects fund	NA	48.7	Plug, using total minus other #s
10	Total resources (old)/Adjusted governmental revenues (new)	3,911.0	3,940.9	Rating agency presentation, p8
11	Less RSF at the beginning of the year	(60.4)	NA	
12	Net resources	3,850.6	NA	
13	Target % reserve	6.0%	10.0%	6.0%
14	Target \$ reserve	231.0	394.1	236.5
15	Increase reserve in FY11 for new policy IF in effect in FY11. This is the amount spending would have had to be reduced in FY11 if new policy were in effect.		163.1	
16				
17	Spending	3,680.0	3,516.9	3,674.5
18	Reduction in FY11 if new policy were in effect.		(163.1)	(5.4)
19	To mitigate the impact of increasing the % reserve from 6% to 10%, the CE proposes to phase in the increase over			
20	the 9 year period FY12-20.			

	A	B	C	D	E	F	G	H	I	J	K
1	RESERVE, PROPOSED NEW POLICY, May 2010										
2	What is the difference in spending permitted by the old 6% policy and the new 10% policy?										
3	Phase in the increase from 6% to 10% over the 9 year period FY12-21.										
4	Agency spending excludes debt service, current revenue funding of the CIP, prefunding of retiree health insurance.										
5	Agency spending in old policy from FY12-16 is from OMB, reflecting Council approved budget for FY11.										
6	Agency spending in new policy from FY12-16 is from OMB, reflecting Council approved budget for FY11.										
7	\$ million										
8											
9		Old			New			Decrease spending			
			Agency	Budgeted		Agency	Budgeted			Increase	New reserve
10	FY	% reserve	spending	reserve	% reserve	spending	reserve	Amount	%	reserve	as % of old base
11	11	6.0%	3,391.8	231.1	6.0%	3,391.8	231.1	0.0	0.0%	0.0	6.0
12	12	6.0%	3,416.2	242.3	6.3%	3,395.3	255.0	(20.9)	-0.6%	12.7	6.3
13	13	6.0%	3,375.9	244.1	6.9%	3,343.4	280.7	(32.5)	-1.0%	36.6	6.9
14	14	6.0%	3,439.7	252.7	7.2%	3,416.9	303.4	(22.8)	-0.7%	50.7	7.2
15	15	6.0%	3,585.2	264.6	7.8%	3,547.7	343.9	(37.5)	-1.0%	79.3	7.8
16	16	6.0%	3,754.7	275.7	8.4%	3,715.9	384.5	(38.8)	-1.0%	108.8	8.4



BEST PRACTICE

Appropriate Level of Unrestricted Fund Balance in the General Fund (2002 and 2009) (BUDGET and CAAFR)

Background. Accountants employ the term *fund balance* to describe the net assets of governmental funds calculated in accordance with generally accepted accounting principles (GAAP). Budget professionals commonly use this same term to describe the net assets of governmental funds calculated on a government's budgetary basis.¹ In both cases, fund balance is intended to serve as a measure of the financial resources available in a governmental fund.

Accountants distinguish up to five separate categories of fund balance, based on the extent to which the government is bound to honor constraints on the specific purposes for which amounts can be spent: *nonspendable fund balance*, *restricted fund balance*, *committed fund balance*, *assigned fund balance*, and *unassigned fund balance*.² The total of the last three categories, which include only resources without a constraint on spending or for which the constraint on spending is imposed by the government itself, is termed *unrestricted fund balance*.

It is essential that governments maintain adequate levels of fund balance to mitigate current and future risks (e.g., revenue shortfalls and unanticipated expenditures) and to ensure stable tax rates. Fund balance levels are a crucial consideration, too, in long-term financial planning.

In most cases, discussions of fund balance will properly focus on a government's general fund. Nonetheless, financial resources available in other funds should also be considered in assessing the adequacy of unrestricted fund balance (i.e., the total of the amounts reported as committed, assigned, and unassigned fund balance) in the general fund.

Credit rating agencies monitor levels of fund balance and unrestricted fund balance in a government's general fund to evaluate a government's continued creditworthiness. Likewise, laws and regulations often govern appropriate levels of fund balance and unrestricted fund balance for state and local governments.

Those interested primarily in a government's creditworthiness or economic condition (e.g., rating agencies) are likely to favor increased levels of fund balance. Opposing pressures often come from unions, taxpayers and citizens' groups, which may view high levels of fund balance as "excessive."

Recommendation. The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund.³ Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and

¹ For the sake of clarity, this recommended practice uses the terms GAAP fund balance and budgetary fund balance to distinguish these two different uses of the same term.

² These categories are set forth in Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which must be implemented for financial statements for periods ended June 30, 2011 and later.

³ Sometimes restricted fund balance includes resources available to finance items that typically would require the use of unrestricted fund balance (e.g., a contingency reserve). In that case, such amounts should be included as part of unrestricted fund balance for purposes of analysis.

specific plans for increasing or decreasing the level of unrestricted fund balance, if it is inconsistent with that policy.⁴

The adequacy of unrestricted fund balance in the general fund should be assessed based upon a government's own specific circumstances. Nevertheless, GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.⁵ The choice of revenues or expenditures as a basis of comparison may be dictated by what is more predictable in a government's particular circumstances.⁶ Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level. In any case, such measures should be applied within the context of long-term forecasting, thereby avoiding the risk of placing too much emphasis upon the level of unrestricted fund balance in the general fund at any one time.

In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:

- The predictability of its revenues and the volatility of its expenditures (i.e., higher levels of unrestricted fund balance may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile);
- Its perceived exposure to significant one-time outlays (e.g., disasters, immediate capital needs, state budget cuts);
- The potential drain upon general fund resources from other funds as well as the availability of resources in other funds (i.e., deficits in other funds may require that a higher level of unrestricted fund balance be maintained in the general fund, just as, the availability of resources in other funds may reduce the amount of unrestricted fund balance needed in the general fund);⁷
- Liquidity (i.e., a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained); and
- Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose).

Furthermore, governments may deem it appropriate to exclude from consideration resources that have been committed or assigned to some other purpose and focus on unassigned fund balance rather than on unrestricted fund balance.

Naturally, any policy addressing desirable levels of unrestricted fund balance in the general fund should be in conformity with all applicable legal and regulatory constraints. In this case in particular, it is essential that differences between GAAP fund balance and budgetary fund balance be fully appreciated by all interested parties.

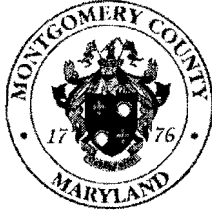
Approved by the GFOA's Executive Board, October, 2009.

⁴ See Recommended Practice 4.1 of the National Advisory Council on State and Local Budgeting governments on the need to "maintain a prudent level of financial resources to protect against reducing service levels or raising taxes and fees because of temporary revenue shortfalls or unpredicted one-time expenditures" (Recommended Practice 4.1).

⁵ In practice, a level of unrestricted fund balance significantly lower than the recommended minimum may be appropriate for states and America's largest governments (e.g., cities, counties, and school districts) because they often are in a better position to predict contingencies (for the same reason that an insurance company can more readily predict the number of accidents for a pool of 500,000 drivers than for a pool of fifty), and because their revenues and expenditures often are more diversified and thus potentially less subject to volatility.

⁶ In either case, unusual items that would distort trends (e.g., one-time revenues and expenditures) should be excluded, whereas recurring transfers should be included. Once the decision has been made to compare unrestricted fund balance to either revenues or expenditures, that decision should be followed consistently from period to period.

⁷ However, except as discussed in footnote 4, not to a level below the recommended minimum.



Montgomery County, Maryland County Council Work Session

*Proposed Fund Balance Policy Resolutions & Bill 36-10:
Revenue Stabilization Fund – Amendments*

June 14, 2010
presented by

Nancy Winkler, Managing Director
Financial Advisor to the County

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Presentation Overview



- I. Overview of Financial Risks and Recommended Policy Changes
- II. Rating Agency Commentary
- III. Summary of PFM Recommendations and County Response
- IV. GFOA Best Practices



Overview of Financial Risks and Recommended Policy Changes



3

Summary of Rating Action Taken by Moody's Investors Service



- On April 2, 2010, Moody's Investors Service notified the County that it has been placed on "Watchlist Negative" meaning that Moody's was intending to take action on the County's rating within ninety days
- This rating action was based on a number of factors including (but not limited to):
 - A multi-year decline in County unreserved, undesignated General Fund and Rate Stabilization Fund balances to levels that are inconsistent with a Aaa rating
 - Notwithstanding recent accomplishments in slowing budgetary growth, the County has a recent history of structurally imbalanced budgets
 - Economically sensitive revenue sources within the County's revenue base produced far less than projected for three consecutive years
- There are two outcomes to being placed on "Watchlist Negative":
 1. Downgrade, most likely to the Aa1 level in the County's case
 2. Removal from "Watchlist Negative" and affirmation of Aaa rating



4

PFM Made a Series of Recommendations in Response to Moody's Action



- In response to Moody's action, the County asked PFM evaluate the County's financial situation, focusing especially on the County's:
 - Reserve policies, and
 - Budgetary practices
 - FY2011 budget
- PFM made a series of recommendations to the County, which are reflected in a report delivered to the county and in the County Executive's proposals to Council

Fund Balance Provides Liquidity to Protect Against Current and Future Risks

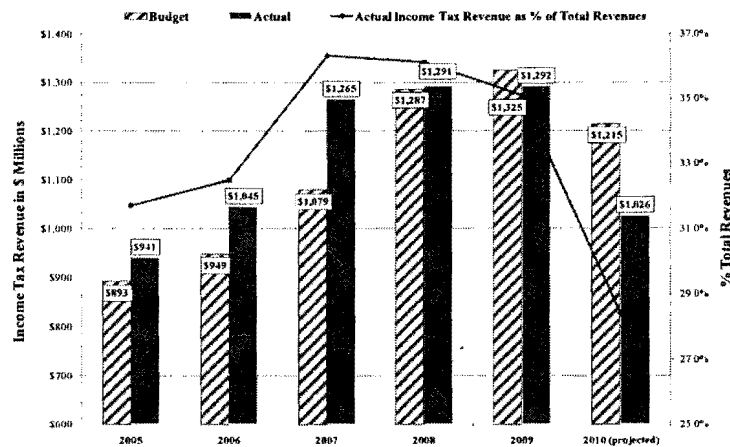


- A well designed fund balance policy will consider:
- The cash flow timing - liquidity needs of a government;
 - The need to have contingencies for unexpected expenditures, such as extraordinary snow removal or emergencies;
 - Predictability of revenues and the volatility of expenditures – higher fund balance may be needed if revenue sources and or expenditures are unpredictable;
 - The potential need to fund unexpected capital situations;
 - The ability to respond to any revenues shortfall with expenditure adjustments within a fiscal year
 - How a government will replenish any draws on fund balance;
 - A policy on structural balance so the budget does not use nonrecurring revenues (which is fund balance, sale of assets, etc) for recurring expenditures.
 - How many years (or months) of exposure the government wants to protect for (3 months is often the standard).
 - How cyclical the government's revenues are, and what other exposures are (for example, is the government dependent on a large employer that can cut back with no notice)

The County's Income Tax Revenue Has Been Hit Especially Hard by the Economic Downturn



Montgomery County, Maryland
Budgeted vs. Actual Income Tax Revenues Only, FY 2005-2010



Source: Montgomery County, Maryland Approved Capital and Operating Budgets, FY 2005 - FY 2011 & Department of Finance, 4/30/2010



Montgomery County's Cash Flow Position



- Certain revenues are seasonal:
 - Property tax
 - Income tax
- Expenditures are generally not seasonal:
 - Salaries and benefits
 - Contractual payments
 - Actions to eliminate expenditures may take some time
- Fund Balance needs to provide for any mismatch in the timing of receipts and expenditures



Proposed Target Reserve Levels through 2020



- The following reserve levels are reflective of PFM's recommendations with the goal of setting aside reserves equal to 10% of Adjusted Governmental Fund Revenues by 2020

Fiscal Year Ending	General Fund Revenues (\$MM)	Adj. Gov'tal Fund Revenues (\$MM)	General Fund (Unreserved/Undesignated)			Revenue Stabilization Fund			Total		
			Fund Balance (\$MM)	% of Prior Year General Fund Revenues	% of Gov'tal Fund Revenues	Fund Balance (\$MM)	% of General Fund Revenue	% of Gov'tal Fund Revenue	Fund Balance (\$MM)	% of General Fund Revenue	% of Gov'tal Fund Revenue
2010	2,814.00	3,388.49 ⁽¹⁾	49.40	0.2%	0.1%	37.70	1.3%	1.1%	87.10	3.1%	2.6%
County Projected											
Future Policy											
2011	2,738.00	3,801.87	140.70	5.0%	3.1%	92.80	3.4%	2.4%	233.50	8.5%	8.0%
2012	2,892.00	4,080.32	136.90	5.0%	3.4%	118.90	4.2%	2.9%	255.80	9.0%	6.3%
2013	2,910.00	4,082.32	141.60	5.0%	3.5%	138.70	4.9%	3.4%	280.30	10.0%	6.9%
2014	2,932.00	4,208.94	140.50	5.0%	3.3%	182.40	6.5%	3.9%	302.90	10.3%	7.2%
2015	3,102.00	4,400.00	146.60	5.0%	3.3%	198.60	6.3%	4.5%	343.20	11.1%	7.8%
2016	3,226.00 ⁽²⁾	4,569.05	155.10	5.0%	3.4%	228.70	7.1%	5.0%	383.80	11.9%	8.4%
2017	3,355.12 ⁽²⁾	4,751.81 ⁽²⁾	181.30	5.0%	3.4%	254.99	7.6%	5.4%	416.29	12.4%	8.9%
2018	3,489.33 ⁽²⁾	4,941.88 ⁽²⁾	187.78	5.0%	3.4%	286.12	8.2%	5.6%	453.88	13.0%	9.2%
2019	3,628.90 ⁽²⁾	5,139.56 ⁽²⁾	174.47	5.0%	3.4%	330.23	9.1%	6.4%	504.70	13.9%	9.8%
2020	3,774.08 ⁽²⁾	5,345.14 ⁽²⁾	181.45	5.0%	3.4%	354.76	9.4%	6.6%	536.21	14.2%	10.0%

(1) Projected at 4% Growth Per Annum

(2) Total Governmental Funds Revenues Projected at 4% Growth Per Annum Using Audited FY09 Value of \$1,758 Million

Rating Agency Commentary



The County's Credit is Currently Being Reviewed by All Three Rating Agencies



- All three Rating agencies have expressed concerns with the County's reserve balances and budgetary flexibility
- In reports related to the County's recent bond issuance in April of 2010, all three rating agencies expressed concerns that may lead to an eventual downgrade:
 - *"Placement on Watchlist for possible downgrade reflects deterioration of the County's financial position driven primarily by income tax revenue shortfalls, which is expected to result in the use of a significant portion of the County's General Fund and Revenue Stabilization Fund as of fiscal 2010 (year ends June 30th). Future rating reviews will factor (a) management's ability to mitigate the projected current year operating deficit, given identification of a number of potential gap closing measures that are largely non-recurring in nature; (b) steps taken in the 2011 budget to restore structurally balanced operations and (c) development of a plan to restore the financial flexibility to levels in keeping with the current rating category."* (Moody's Investors Service, April 2010)

The County's Credit is Currently Being Reviewed by All Three Rating Agencies



- *"Failure to restore reserves to levels consistent with the 'AAA' rating and the county's long-standing policies could place downward pressure on the rating."* (Fitch Ratings, March 25, 2010)
- *"The county has stated that by fiscal 2012 it will eliminate the currently projected \$212 million structural deficit and will restore reserves to its 6% policy. Fitch's current rating and Stable Outlook assume the county will be successful, but failure to achieve the fiscal 2011 and 2012 financial goals could result in a credit profile that is inconsistent with the current rating category."* (Fitch Ratings, March 31, 2010)
- *"The stable outlook reflects the inherent strength of the county's economy and Standard & Poor's expectation that the county will continue to take the steps necessary to restore its financial footing by addressing ongoing revenue declines. If the county fails to take actions to stabilize its finances, we may revise the outlook to negative."* (Standard & Poor's, March 31, 2010)

One of the Key County Weaknesses is Volatility in its Tax Revenue Streams



- The County can accurately predict and budget for property tax revenues mainly due to the Homestead Tax Credit
- The County has experienced much greater discrepancies between budgeted and actual income tax, transfer tax and recordation tax revenues
- The County has historically projected that total tax revenues will be equal to or higher than prior year actual revenues in its budgetary process; this approach worked during FY05-07, this same approach became problematic in the face of the current recession
- *"The county's revenue base includes a number of economically-sensitive revenue sources (income, recordation and transfer taxes) that generated significant budgetary surpluses during the real estate market boom period of fiscal 2004 to fiscal 2007 but are driving the current financial deterioration."*
(Moody's Investor Service, April 5, 2010)

Summary of PFM Recommendations and County Response



Recommendation #1: Act swiftly and decisively as part of the FY 2011 budget process to significantly restore target fund balance levels



- The combined fund balances of its unreserved, undesignated General Fund Balance and Revenue Stabilization Fund ("RSF") in FY 2011 should be restored to its current policy goal of 6% of tax supported resources
- Simultaneously, the County should institute a multi-year plan to phase in a new policy which establishes higher unreserved undesignated General Fund Balance and Revenue Stabilization Fund to levels which reflect the County's specific liquidity needs given its cash flow and economically sensitive revenue streams

Recommendation #2: Amend local law with respect to the RSF



- Remove the provision which establishes a maximum amount permitted in the RSF
- Provide for a mandatory contribution to the RSF equal to 0.5% of Adjusted Governmental Fund Revenues. This provision would require a budgeted annual contribution until the combined ending balances of the General Fund and the RSF equals 10% of Adjusted Governmental Fund Revenues

Recommendation #3: Establish and meet targets for the combined ending General Fund and RSF balance by FY 2020



- FY 2011 unreserved General Fund balance must be restored to 5% of prior year General Fund revenues
- FY 2011 RSF must be restored to at least 1.0% of General Fund Revenues
- Further, PFM recommends that the County needs to target and maintain a reserve balance (made up of unreserved, undesignated General Fund reserves and the Revenue Stabilization Fund) equal to 10% of Adjusted Governmental Fund Revenues
- The County should plan to reach the reserve balance target no later than 2020
- This reserve target provides 36 days of working capital reserves, and should be sufficient to withstand shocks created by another recession of the same severity as the 2008-2010 recession

Recommendation #4: Strengthen its budget policy requiring the County to adopt a structurally balanced budget



- PFM supported the County's revision to its FY2011 income tax revenue projections to remove any level of optimism in the income tax projection, which led to the need to make further difficult cuts
- PFM suggested the County add the following language to its Balanced Budget Policy
 - Montgomery County will have a structurally balanced budget. Recurring revenues should fund recurring expenses. No deficit may be planned or incurred. In the event that the County determines that reserves have been fully funded, then to the extent that there are surplus reserves, these funds should be budgeted to fund any of the following non-recurring expenditures which are one-time in nature, fund pay-go for capital in excess of the County's targeted goal for pay-go or to advance fund unfunded liabilities such as OPEB. (The County may want to add in other non- recurring items)

County Executive has Recently Proposed Resolutions Reflective of PFM's Recommendations



- On May 21, 2010, County Executive recommended new fund balance policies and changes to the Revenue Stabilization Fund law
- On May 27, 2010, County Council introduced a new resolution with new fund balance policies
- County Council also introduced Bill 36-10 – Revenue Stabilization Fund ("RSF") – Amendments
- County Council passed revised FY2011 budget with changes to increase revenues (energy tax, telephone tax) and lower expenditures reaching the current 6% fund balance policy level
- Maryland Board of Education has recently approved the County's Maintenance of Effort ("MOE") waiver request, also assisting with the budgetary process

GFOA Best Practices



GFOA Best Practices Recommendations



- The Government Finance Officers Association (GFOA) recommends that governments establish a formal policy on the level of unrestricted fund balance that should be maintained in the general fund
- Such a guideline should be set by the appropriate policy body and should provide both a temporal framework and specific plans for increasing or decreasing the level of unrestricted fund balance, if it is inconsistent with that policy
- GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures
- Furthermore, a government's particular situation often may require a level of unrestricted fund balance in the general fund significantly in excess of this recommended minimum level

GFOA Guidelines Concerning Establishing a Reserve Fund Policy



- In establishing a policy governing the level of unrestricted fund balance in the general fund, a government should consider a variety of factors, including:
 - The predictability of its revenues and the volatility of its expenditures
 - Its perceived exposure to significant one-time outlays (disasters, immediate capital needs, state budget cuts, etc.)
 - The potential drain upon general fund resources from other funds as well as the availability of resources in other funds
 - Liquidity (if there is a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities)
 - Commitments and assignments (i.e., governments may wish to maintain higher levels of unrestricted fund balance to compensate for any portion of unrestricted fund balance already committed or assigned by the government for a specific purpose)



OFFICE OF MANAGEMENT AND BUDGET

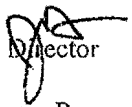
Isiah Leggett
County Executive

Joseph F. Beach
Director

MEMORANDUM

June 21, 2010

TO: Nancy Floreen, Council President

FROM: Joseph F. Beach, Director 

SUBJECT: Bill 36-10, Finance – Revenue Stabilization Fund – Amendments

The purpose of this memorandum is to transmit a fiscal impact statement to the Council on the subject legislation.

LEGISLATION SUMMARY

The proposed bill was included in a package of recommendations the County Executive transmitted to the County Council on May 21, 2010 which also included revisions to the County's reserve policy and changes to the County's fiscal practices to address structural imbalances in the budget. Taken together, the actions are intended to increase reserve levels to 10% by 2020 or sooner and to achieve structural budgetary balance. The proposed legislation will amend the Revenue Stabilization Fund law to remove the cap on the Fund, retain interest earned in the Fund, and require mandatory contributions to the Fund to achieve total reserves of 10%.

FISCAL AND ECONOMIC SUMMARY

Compared to existing law and current reserve policies, the proposed amendments removing the cap on the maximum size of the fund and requiring mandatory contributions to achieve a total reserve level of 10% will have a positive fiscal impact by ensuring that the County has adequate reserves to fund its operations through its annual revenue and expenditure cycle, and also is intended to assure that the County will continue to receive the highest possible ratings on its general obligation bonds and the lowest costs of borrowing. The mandatory direction of resources to reserves will limit the amount of resources available to spend on agency operating budgets or other uses, including capital investment.

This latter impact can be seen by comparing the two fiscal plan displays attached to this memorandum, versions of which were included in the Council's discussion packet on this bill on June 14, 2010. The first display assumes current policy and existing law, while the second incorporates the recommended changes to reserve and fiscal policies and the Revenue Stabilization Fund law.

While the proposed changes will most directly impact the amount of resources available for agency spending, they will more importantly set the County on a stronger fiscal path for FY11 and beyond. The changes will strengthen the County's capacity to withstand severe revenue declines or

Office of the Director

Nancy Floreen, President, County Council
June 21, 2010
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unexpected expenditure needs such as those experienced in the last year. They will also help ensure there is sufficient working capital throughout the County's uneven revenue collection cycle. And, as highlighted by the County's financial advisor, the proposed changes to the Revenue Stabilization Fund will allow total reserves to increase to a level more in line with other AAA-rated counties across the country. Overall, this set of actions will provide additional flexibility to the County to respond to further adverse economic and fiscal conditions.

The proposed legislation is not expected to have a material economic impact. The following contributed to and concurred with this analysis: Karen Hawkins, Department of Finance.

JFB:ae

Attachments

- c: Kathleen Boucher, Assistant Chief Administrative Officer
- Rebecca Domaruk, Offices of the County Executive
- Jennifer Barrett, Director, Department of Finance
- Karen Hawkins, Department of Finance
- Alex Espinosa, Office of Management and Budget
- John Cuff, Office of Management and Budget

Testimony: Bill 36-10, Finance – Revenue Stabilization Fund - Amendments

Good afternoon, I am Jennifer Barrett, Director of the Department of Finance, and I am here to testify on behalf of County Executive Isiah Leggett on Bill 36-10 Finance – Revenue Stabilization Fund - Amendments. The County Executive urges the Council to support Bill 36-10 which, along with the accompanying “Reserve and Selected Fiscal Policies” Resolution, is designed to strengthen the County’s fiscal health, by building reserve levels to sufficient amounts to support County operations, and to provide a sufficient contingency based on the County’s unique revenue and expenditure needs.

Bill 36-10 provides for a series of fixed-level mandatory contributions to the Revenue Stabilization Fund (RSF) that are in addition to the existing revenue-based mandatory contributions, and the bill removes the cap on the size of the RSF. The requirements are designed to build up the County’s reserves to the new, ten percent policy level (10% of Adjusted Governmental Revenues) recommended by the County’s Financial Advisor, Public Financial Management (PFM). The 10% goal is viewed as only modest, given the County’s heavy reliance on volatile, economically sensitive revenue sources, such as the income tax and transfer and recordation taxes, and based on the County’s cash flow needs in relation to the timing of the collection of its primary revenue sources. Therefore, the recommended legislation removes the cap on the Revenue Stabilization Fund, so that, after the targeted policy level is met with fixed-level mandatory contributions, the existing provisions for revenue-based mandatory contributions will continue, if triggered, and allow the fund to grow further. This further growth will occur only if revenues come in higher than projected, and then only fifty percent (50%) of the overage will be deposited into the Revenue Stabilization Fund.

The legislation and accompanying policy resolution before you will set the County on a stronger fiscal path in FY11 and beyond. The needs for these actions are many, and include our recent experiences with severe reductions in revenues and unanticipated expenditure pressures; the remaining potential for future State actions which may negatively affect the County’s revenues and/or place additional expenditure requirements on the County; numerous one-time actions taken to solve the FY10 and FY11 budget challenges; and strong statements of concern regarding the County’s use of reserves, reserve levels, and budgetary structural balance contained in all three Rating Agencies’ most recent ratings reports.

The combination of these actions is estimated to achieve structural budgetary balance and grow reserve levels to 10% by 2020 or sooner: enough to sustain the

County through a variety of the pressures noted above. The reserve amounts will also help ensure sufficient working capital through the County's usual fiscal cycle.

I urge the Council to approve Bill 36-10, as well as the Resolution to Approve Reserve and Selected Fiscal Policies. Guided by this set of actions, we will restore General Fund reserves to the maximum allowed Charter level, and plan for a series of mandatory contributions to the Revenue Stabilization Fund to achieve a total reserve level of 10%. We will have strengthened our policies regarding a balanced budget and use of one-time revenues, and commit to return to our existing PAYGO policy. Although the Council's actions to adopt this legislation and policy resolution is important, it is equally important for the County to adhere to these policies, and set the County on a stronger fiscal path for FY12 and beyond, ready to respond to further adverse economic and fiscal conditions that will inevitably occur at some point in our future.

Thank you for your time.

June 22, 2010

Allocation of Total Reserve

(\$ in millions)

	App. FY10	Est. FY10	App. FY11	Projected FY12	Projected FY13	Projected FY14	Projected FY15	Projected FY16
1 <u>Executive's Ending Reserves</u>								
2 Unrestricted General Fund	76.2	29.7	136.8	136.4	141.8	140.7	146.8	155.3
3 Revenue Stabilization Fund	119.6	60.4	94.3	118.6	139.0	162.7	197.1	229.2
4 Total Ending Reserves	195.8	90.1	231.2	255.0	280.7	303.4	343.9	384.5
5 Reserves as a % of Adjusted Governmental Revenues			6.0%	6.5%	7.1%	7.4%	8.0%	8.6%
6								
7								
8 <u>Alternative allocation of reserves between General Fund and RSF, same total as Executive</u>								
9 Unrestricted General Fund	76.2	29.7	136.8	127.5	140.4	140.7	146.8	155.3
10 Revenue Stabilization Fund	119.6	60.4	94.3	127.5	140.4	162.7	197.1	229.2
11 Total Ending Reserves	195.8	90.1	231.2	255.0	280.7	303.4	343.9	384.5